

BEFORE THE TENNESSEE REGULATORY AUTHORITY

NASHVILLE, TENNESSEE

JANUARY 28, 2002

IN RE:

**AQUA UTILITIES COMPANY, INC.
COMPLIANCE AUDIT**

)
)
)
)

**DOCKET NO.
00-01105**

**ORDER ADOPTING COMPLIANCE AUDIT REPORT OF TENNESSEE
REGULATORY AUTHORITY'S ENERGY AND WATER DIVISION**

This matter came before the Tennessee Regulatory Authority (the "Authority") at a regularly scheduled Authority Conference held on December 18, 2001, for consideration of the Compliance Audit Report (the "Report") relative to Aqua Utilities Company, Inc. ("Aqua" or the "Company") by the Authority's Energy and Water Division (the "Staff"). The Compliance Audit Report, attached hereto as Exhibit 1, contains the audit findings of the Staff, the responses thereto of the Company, and the recommendations of the Staff to the Company in addressing the findings.

The Compliance Audit Report

According to the Report, Aqua is a small water and wastewater system located on Pickwick Landing Lake near Savannah, Tennessee in Hardin County. Aqua, which is owned solely by Mr. James E. Clausel, currently has approximately 149 water and 118 wastewater customers.

The Staff began its audit of the Company on January 17, 2001 and completed its audit on October 22, 2001. On September 25, 2001, the Staff issued its preliminary compliance audit findings to the Company, and the Company responded to these findings on October 12, 2001.

The Staff filed its Report with the Authority on October 23, 2001. The Report contains eleven (11) findings. The Report prefaces these findings with the statement that the "Company has not come under review by this Agency since 1993 (Docket No. 93-03246)."¹ The Report further states that the Company "has serious accounting difficulties with regulatory procedures as required by this agency."²

Finding No. 1 is that the Company does not keep its books in accordance with the Uniform System of Accounts ("USOA") as required by Authority Rule 1220-4-1-.11(1)(g). The Staff recommended that the Company make the necessary changes in its accounting methods and procedures to comply with the USOA and provide Staff with evidence of compliance no later than thirty (30) days after the Authority's approval of the Report. According to the Report, the Company responded that it will bring its books into compliance with the USOA.

Finding No. 2 is that Aqua intermingled its records with those of Montana Land Company, LLC ("Montana"), a real estate development company also owned by Mr. Clausel. According to the Report, this intermingling has resulted in no plant or liabilities being recorded on Aqua's books. Thus, the Report states, it is impossible to produce a balance sheet that accurately reflects the Company's assets. The Staff recommends that the Company take the necessary measures to determine in the future that all utility transactions are recorded on the Company's books. According to the Report, the Company responded that it will comply with the Staff's recommendation.

Finding No. 3 is that the Company did not seek approval for debt acquired during 1996. The Report states that on September 30, 1996, Mr. Clausel entered into a loan agreement with Columbus Bank and Trust Company to assume liability for debt acquired during 1992 by the

¹ Report, October 23, 2001, p. 3.

² *Id.*

Company's prior owner. The Report further states that the assets of Montana were pledged as the primary collateral for the 1996 loan, with Aqua's assets being pledged as secondary collateral. The Report notes that Tenn. Code Ann. § 65-4-109 requires that any debt issuance by a public utility having a maturity date beyond one (1) year be approved by the Authority.

The Report states that since the Company did not have to bear the cost of construction at the inception of its operations, no portion of the debt acquired by Montana should be attributed to Aqua. The Staff recommends that the Company be directed to remove the lien against its assets since the debt is related only to Montana's operations, and that the Company should provide proof to the Staff that the lien has been removed within sixty (60) days after the Authority's approval of the Report.

According to the Report, the Company responded that it "desire[s] to explore this issue further."³ The Company stated that it believed that the debt assumed from the previous owner was a result of utility plant construction and was so authorized by an Order of the Tennessee Public Service Commission ("TPSC"). The Company further stated that it is doubtful that a bank would accept a substitute collateral, and that the Company was unaware of the provisions of Tenn. Code Ann. § 65-4-109.

Finding No. 4 is that the Company has authorized members of its accounting firm, Williams, Jerrolds, Godwin & Nichols, PLLC to sign Company checks from the Company's bank account. The Report states that the Staff is "greatly concerned" over this finding, which indicates a "lack of daily management on the part of the Company."⁴ The Staff recommends that the Company should remove all outside parties from its bank accounts immediately and submit proof of compliance with this recommendation to the Authority within thirty (30) days of the

³ *Id.*, p. 7.

⁴ *Id.*, p. 9.

Authority's approval of the Report. According to the Report, the Company responded that it "has removed all outside parties from its bank accounts."⁵

Finding No. 5 is that the Company did not seek approval for the transfer of its Certificate of Public Convenience and Necessity ("CCN") at the time the Company was sold to Mr. Clausel. The Report notes that having failed to obtain approval of the transfer, the Company has not complied with Tenn. Code Ann. § 65-4-113, which requires Authority approval of a transfer of the authority to provide utility service derived from a public utility's CCN. The Staff recommends that the Company file with the Authority a petition requesting the approval of the transfer of authority within thirty (30) days after the Authority's approval of the Report. According to the Report, the Company responded that it will comply by requesting approval of the transfer of authority.

Finding No. 6 is that the Company did not comply with the directives of TPSC Order No. 90-04334, which directed the Company to record \$453,000 in capitalized plant costs and allocate \$203,000 of such costs to water and \$250,000 to wastewater. The Report states that the plant costs were to be borne by the developer at no cost to the Company which would result in contributed capital to the Company. According to the Report, the Company has failed to make the entries required by TPSC Order No. 90-04334 on its books and has failed to make the associated charges to its Accumulated Depreciation and CIAC (Contributions in Aid of Construction) Amortization accounts. The Staff recommends that the Company comply with TPSC Order No. 90-04334. According to the Report, the Company responded that it will comply with Staff's recommendation by making the necessary accounting entries.

Finding No. 7 is an over-collection of \$5,775 in tap installation costs. The Report explains that the Company's tariff contains a \$250 tap fee as well as language to the effect that,

⁵ *Id.*

if the cost of the tap is more than \$250, the customer will pay the additional cost. According to the Report, the Company arranges to have lines installed from the customer's home to the utility main. Such lines, which the Company does not own, then become the responsibility of the customer. The Company uses a single contract to install the lines and charges each customer \$4,000 for line installation for both water and wastewater. However, according to the Report, Company-supplied invoices indicated charges for these installation services ranging from \$325 to \$3,650, and the additional amount is considered "profit" by the Company.⁶ At the same time, the Report states, the Company shows no CIAC recorded on its books.

The Report explains that under its tariff, the Company is only allowed to charge \$250 plus any additional costs for line installation, and is not authorized to make a profit. The Report states that tap fees authorized by the Authority are not intended to allow a public utility to make a profit, but only to assist the utility with initial plant cost incurred at start-up. According to the Report, the Company should have charged only \$3,650, the amount charged by the contractor.

With respect to the seventh finding, the Staff recommends that the Company cease immediately the collection of funds beyond the charge for installing the customer's line and that the Company's customers be allowed to choose a contractor independently, as long as lines are installed according to the Company's specification. The Staff recommends two possible ways for the Company to address the previous over-collection of tap fees, either to identify those customers who were erroneously charged and refund the over-collections or to record the over-collected amount as CIAC, split evenly between water and wastewater. According to the Report, the Company responded that it will record the over-collected amount as CIAC but is "concerned about the quality of equipment, construction and installation ratepayers will use in connecting to

⁶ *Id.*, p. 12.

Aqua's facilities," one particular concern being that "reduced pressure backflow preventors may not be installed by the ratepayer."⁷

Finding No. 8 is that the Company currently charges a \$250 fee for installation of an additional water meter for irrigation purposes but does not have a charge for irrigation purposes identified in its tariff. The Staff recommends that the Company seek approval to charge an irrigation meter fee and file an amended tariff to reflect the irrigation meter charge. According to the Report, the Company responded that it will comply with the Staff's recommendation.

Finding No. 9 is that the Company recorded \$4,650 in repair expense during 2000 for the replacement of a lift station pump. The Report states that this replacement expense should have been capitalized, pursuant to the USOA. The Staff recommends that the Company make the required entries and provide proof that it has complied with the Staff's directives within thirty (30) days after the Authority approves the Report. According to the Report, the Company responded that it will comply with the Staff's recommendation.

Finding No. 10 is that the Company expensed \$250, which it spent for tax return preparation services during 1999. The Report states that for ratemaking purposes, recovery of this type of expense is not allowed through rates charged to ratepayers. The Report notes that Aqua is a subchapter "S" corporation and all of the net income or loss of such an entity is reported by each shareholder on his or her individual personal income tax return. The Report states that since the cost related to the utility cannot be identified in the tax preparation expense, recovery of this cost is generally not allowed. The Staff recommends that the \$250 expense be disallowed for ratemaking purposes and an entry be made in non-utility expenses to reflect the proper accounting treatment. The Staff further states that in the future this expense should not be paid by the Company but by Mr. Clausel personally.

⁷ *Id.*, p. 13.

According to the Report, the Company responded that it does not contest whether the charges for tax return preparation should be allowed to be recovered through rates charged to ratepayers. The Company did, however, state that "it is a commonly accepted practice that all U.S. corporations pay their own legal and accounting fees for services rendered that corporation."⁸ The Company stated that it should be allowed to pay for such services.

Finding No. 11 is that the Company did not record any accumulated depreciation or amortization related to capital expenditures. The Report states that the depreciation and amortization charges associated with certain items that the Company failed to capitalize were, as calculated by the Staff, \$55,825 for water and \$68,831 for wastewater. The Staff recommends that the Company make the above entries to comply with the Authority's directives. According to the Report, the Company responded that it will comply with the Staff's recommendation.

At the Authority Conference held on December 18, 2001, after consideration of the Report, the Directors of the Authority unanimously approved and adopted the findings and recommendations contained therein, with certain exceptions. As to the Staff's recommendation, contained in Finding No. 3, that the Company be required to remove the lien, the Directors determined that the issue of the lien should be addressed when the Company submits a petition for approval of the loan. As to the Staff's comments regarding Finding No. 7, the Directors agreed with the Staff that the Company should pass through only its actual cost to its customers and discontinue its practice of billing a flat fee in excess of its cost. The Directors also determined that the over-collected amount for 2000 should be treated as CIAC. The Directors then agreed that the Staff and the Company should collaborate to arrive at a mutual resolution of the issue of tap fees and choice of contractors, and that this resolution should be submitted to the Directors for approval. With respect to Finding No. 10, the Directors agreed with the

⁸ *Id.*, p. 16.

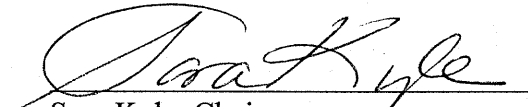
Company's response and requested that the Staff reevaluate its finding to determine an appropriate treatment of the tax preparation expense.

IT IS THEREFORE ORDERED THAT:

1. With the exceptions noted in this Order, the Compliance Audit Report of Aqua Utilities Company, Inc., a copy of which is attached to this order as Exhibit 1, is approved and adopted, and the findings and recommendations contained therein are incorporated in this Order as if fully rewritten herein.

2. With the exceptions noted in this Order, the Company shall comply with the Staff's recommendations contained in the Report and submit proof of such compliance as directed in the Report.

3. The Company shall cooperate with the Staff in arriving at a mutual resolution of the issue of tap fees and choice of contractor, and this resolution shall be submitted to the Directors for approval.


Sara Kyle, Chairman


H. Lynn Greer, Jr., Director


Melvin J. Malone, Director

ATTEST:


K. David Waddell, Executive Secretary